

Part III - Administrative, Procedural, and Miscellaneous

Cell Captive Insurance Arrangements: Insurance Company Characterization and Certain Federal Tax Elections.

Notice 2008-19

SECTION 1. PURPOSE

Rev. Rul. 2008-8, this Bulletin, provides guidance on the standards for determining whether an arrangement between a participant and cell of a Protected Cell Company (defined below) constitutes insurance for federal income tax purposes, and whether amounts paid to the cell are deductible as "insurance premiums" under § 162 of the Internal Revenue Code. The purpose of this notice is to request comments on further guidance to address issues that arise if those arrangements do constitute insurance, specifically (a) the status of such a cell as an insurance company within the meaning of §§ 816(a) and 831(c), and (b) some of the consequences of a cell's status as an insurance company.

SECTION 2. BACKGROUND

.01 Under §§ 816(a) and 831(c), an insurance company is any company more than half the business of which during the taxable year is the issuing of insurance or annuity contracts or the underwriting of risks underwritten by insurance companies. Although its name, charter powers, and subjection to State insurance laws are significant in determining the business which a

company is authorized and intends to carry on, it is the character of the business actually done in the taxable year which determines whether a company is taxable as an insurance company under the Internal Revenue Code. Treas. Reg. § 1.801-3(a)(1).

.02 A taxpayer that qualifies as an insurance company is treated as a corporation under § 7701(a)(3), even if it would not otherwise be classified as a corporation for state law purposes or under other provisions of the Code. Thus, for example, in Rev. Rul. 83-132, 1983-2 C.B. 270, a non-corporate business entity was held to be an insurance company, and therefore a "corporation" within the meaning of § 7701(a)(3), because its primary and predominant business activity was underwriting insurance risks.

.03 An insurance company is subject to tax under either Part I or Part II of Subchapter L, as applicable, and is eligible to make a number of elections. For example, § 831(b) permits certain small insurance companies other than life insurance companies to elect to be taxed only on taxable investment income (and not on underwriting income); § 846(e) permits an insurance company to compute discounted unpaid losses using the company's historical payment patterns, rather than the historical payment patterns determined by the Secretary under § 846(d); and § 953(d) generally permits a controlled foreign corporation to elect to be treated as a domestic corporation if it would qualify to be taxed under subchapter L (that is, as an insurance company) if it were a domestic corporation. See also Rev. Proc. 2003-47, 2003-2 C.B. 55 (setting forth procedural rules regarding the election under § 953(d)).

.04 A number of jurisdictions have statutes that provide for the chartering of a legal entity commonly known as a protected cell company, segregated account company or segregated portfolio company (“Protected Cell Company”). Rev. Rul. 2008-8, this Bulletin, sets forth facts that are typical of arrangements involving Protected Cell Companies and provides guidance on how to determine whether such an arrangement qualifies as insurance for federal income tax purposes.

.05 Section 3 of this Notice sets forth proposed guidance that would address (a) when a cell of a Protected Cell Company is treated as an insurance company for federal income tax purposes, and (b) some of the consequences of the treatment of a cell as an insurance company. The proposed guidance, if adopted, may take the form of a regulation, revenue ruling, revenue procedure, or other Internal Revenue Bulletin publication.

SECTION 3. PROPOSED GUIDANCE

.01 In general. The proposed guidance would include a rule to the effect that a cell of a Protected Cell Company would be treated as an insurance company separate from any other entity if:

- (a) the assets and liabilities of the cell are segregated from the assets and liabilities of any other cell and from the assets and liabilities of the Protected Cell Company such that no creditor of any other cell or of the Protected Cell Company may look to the assets of the cell for the satisfaction of any liabilities, including insurance claims (except to the

extent that any other cell or the Protected Cell Company has a direct creditor claim against such cell); and

(b) based on all the facts and circumstances, the arrangements and other activities of the cell, if conducted by a corporation, would result in its being classified as an insurance company within the meaning of §§ 816(a) or 831(c).

.02 Effect of insurance company treatment at the cell level. Consistent with the proposed rule:

(a) Any tax elections that are available by reason of a cell's status as an insurance company would be made by the cell (or, in certain circumstances, by the parent of a consolidated group) and not by the Protected Cell Company of which it is a part;

(b) The cell would be required to apply for and receive an employer identification number (EIN) if it is subject to U.S. tax jurisdiction;

(c) The activities of the cell would be disregarded for purposes of determining the status of the Protected Cell Company as an insurance company for federal income tax purposes;

(d) The cell (or, in certain circumstances, the parent of a consolidated group) would be required to file all applicable federal income tax returns and pay all required taxes with respect to its income; and

(e) A Protected Cell Company would not take into account any items of income, deduction, reserve or credit with respect to any cell that is treated as an insurance company under section 3.01.

.03 No inference. No inference should be drawn regarding the treatment of a cell that does not meet the requirements to be treated as an insurance company separate from any other entity under section 3.01 or regarding the treatment of the Protected Cell Company of which it is a part.

.04 Effective date. The proposed guidance would be effective for the first taxable year beginning more than 12 months after the date the guidance is published in final form.

SECTION 4. REQUEST FOR COMMENTS

Statutes under which Protected Cell Companies are chartered differ among various jurisdictions, and cell arrangements differ among taxpayers due to variations in contractual terms. In order to ensure that entity classification and federal tax elections for Protected Cell Companies are both legally correct and administrable in all cases, the Service requests comments on the proposed guidance described in section 3 of this Notice. In particular, the Service requests comments on (a) what transition rules may be appropriate or necessary for Protected Cell Companies, or cells of such companies, if a Protected Cell Company is not currently following the rule in section 3.01, or if a cell of such a company qualifies as an insurance company for some taxable years but not for others; (b) what reporting, if any, would be necessary on the part of an individual cell to ensure that a Protected Cell Company has the information needed to comply with section 3.02(c) and (e); (c) whether different or special rules should apply with respect to foreign entities, including controlled foreign corporations; (d) whether further guidance would be needed concerning the proper treatment of

Protected Cell Companies and their cells under the rules regarding consolidated returns. The Service also requests comments on what guidance, if any, would be appropriate concerning similar segregated arrangements that do not involve insurance. Written comments may be submitted to the Office of the Associate Chief Counsel (Financial Institutions & Products), Attention: Chris Lieu (Notice 2007-YY), Room 3552, CC:FIP:4, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC 20224. Alternatively, taxpayers may submit comments electronically to Notice.Comments@irs.counsel.treas.gov. The Service requests any comments by **INSERT DATE THAT IS 90 DAYS AFTER THIS ITEM IS PUBLISHED IN THE INTERNAL REVENUE BULLETIN.**

DRAFTING INFORMATION

The principal author of this notice is Chris Lieu of the Office of the Associate Chief Counsel (Financial Institutions & Products). For further information regarding this notice, contact Mr. Chris Lieu at (202) 622-3970 (not a toll-free call).